

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

VERIZON NORTH INC. AND VERIZON )  
SOUTH INC. )  
 ) Docket No. 02-0560  
Verified Petition for Certification Pursuant )  
to 220 ILCS 5/13-517 or Waiver Pursuant )  
to 220 ILCS 5/13-517(b) )

**INITIAL BRIEF OF VERIZON NORTH INC.  
AND VERIZON SOUTH INC.**

March 17, 2003

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Verizon North Inc. and Verizon South Inc. (collectively referred to as “Verizon”), through its attorneys, hereby submit this Initial Brief to the Illinois Commerce Commission (the “Commission”). This Brief is filed in accordance with the procedural schedule established by the Administrative Law Judge (“ALJ”).

**I.**  
**Executive Summary**

**A. Introduction**

In June 2001, the General Assembly enacted Section 13-517 of the Public Utilities Act (“Act”). 220 ILCS 5/13-517. This Section requires, unless a waiver is granted, that Incumbent Local Exchange Carriers (“ILECs”) offer to provide advanced telecommunications services to 80% of their customers.

The statute defines advanced telecommunications services as “services capable of supporting, in at least one direction a speed in excess of 200 kilobits per second (“kbps”)....” *Id.* The record clearly demonstrates that Verizon offers existing advanced telecommunications services that provide the required bandwidth in all of its exchanges. Therefore, no further action is required to satisfy Section 13-517. However, if the Commission disagrees with this fact, the record further demonstrates that Verizon should be granted a partial waiver of the Section 13-517

requirements given the nature of its service territory, customer demand for advanced telecommunications services, and the costs to deploy such services. If the waiver is granted, Verizon will implement a Bonafide Request Process (“BFR”) that customers can use to explore any possible way to provide advanced telecommunications services in targeted locations in an economically efficient manner.

**B. Verizon Already Offers Advanced Telecommunications Services To All Of Its Customers**

Verizon currently has technology available throughout its service territory that is capable of transmitting data at greater than 200 kbps. (Verizon Ex. 3.0, White Dir., p. 2). These services are offered through Verizon’s existing intrastate tariffs, and at least one of these services is available to any customer in Verizon’s service territory. (*Id.*, pp. 2-3). As such, no party disputes that all customers within Verizon’s service territory currently can purchase services capable of supporting, in at least one direction, a speed in excess of 200 kbps. This fact alone demonstrates that Verizon’s service offerings meet the requirements of Section 13-517.

The Staff of the Commission (“Staff”) takes the position that Verizon’s current intrastate advanced telecommunications services offerings do not meet the requirements of Section 13-517 based solely on the price of the service. (Staff Ex. 1.0, Liu Dir., p. 12). However, Staff’s arguments fail at their inception because nowhere in Section 13-517 is pricing mentioned. 220 ILCS 5/13-517. Section 13-517 speaks to the capabilities of the advanced telecommunications service being offered or provided, not to price.

In an attempt to support its argument, Staff resorts to manufacturing entirely new definitions for the terms “offered” and “provided,” as such terms are used in the statute. (Staff Ex. 1.0, Liu Dir., pp. 15-16). These manufactured definitions, however, are inconsistent with the common and accepted definitions of these terms. Indeed, the fact that Staff must resort to

convoluted definitions for commonly accepted terms demonstrates that Staff's position is without merit. Therefore, the Commission should decide this case on this issue alone.

**C. Verizon's Waiver Request**

If the Commission does not determine that Verizon's existing service offerings meet the requirements of Section 13-517, then Verizon alternatively seeks a waiver as provided for under the Act. At present, Verizon offers DSL Transport Service ("DSL TS") in certain areas within its service territory to internet service providers ("ISPs"). DSL TS is an interstate service subject to the jurisdiction of the Federal Communications Commission ("FCC"). (Verizon Ex. 2.0, Trimble Dir., p. 5). As such, the Commission does not have the authority to mandate the deployment of this service, or the authority to order that this service be subsidized because the Commission does not have jurisdiction over its pricing. Regulatory oversight of DSL TS and its pricing resides with the FCC.

Notwithstanding jurisdictional issues, which Verizon does not waive, Verizon has demonstrated clearly that the provision of DSL TS in the areas where it is seeking a waiver would be unduly economically burdensome to both Verizon and its customer base. Verizon has provided evidence that demonstrates that even if an unrealistic penetration rate of 17% is utilized, the resulting revenues will not cover the costs associated with deployment necessary to meet the Act. (Verizon Ex. 2.0, Trimble Dir., p. 16). Importantly, this illustrative 17% penetration rate is more than double the actual [REDACTED] penetration rate for DSL TS deployments in Illinois that have been in service for three or more years. (See Verizon Ex. 7.0, Trimble Sur., p. 22).

Accordingly, Verizon is seeking a full waiver of the requirements of Section 13-517 with respect to those areas where it has not currently deployed DSL TS ("Waiver Areas"). (Verizon

Ex. 2.0, Trimble Dir., p. 9). These areas are largely rural and the record demonstrates that the high cost of deploying DSL TS to these areas simply is not economically justified in light of the low penetration rates that Verizon has experienced in the areas where it has already deployed DSL TS. (*Id.*) As such, Verizon could not deploy DSL TS in these areas without the need for substantial subsidization. (Verizon Ex. 4.0, Trimble Reb., p. 19). The record further demonstrates that subsidies are not in the public interest and would cause significant adverse economic impact on users of telecommunications services generally. (*Id.*, p. 20).

If a waiver is granted, Verizon is committed to working with customers in the Waiver Areas to assess requests for DSL TS. In this regard, Verizon proposes to include a BFR Process. The BFR Process provides communities and interest-groups located in the Waiver Areas with the opportunity to work with Verizon to determine whether targeted DSL TS requests can economically be made available. This market-based approach to further DSL TS deployment balances the interests of customers seeking advanced telecommunications services with Verizon's need to make economic and prudent investments related to a competitive service, as well as Verizon's customers generally. It also better promotes the legislative intent that advanced services to be implemented through prudent investment that will promote effective and sustained competition.

Staff opposes Verizon's alternative waiver request, even though Staff and Verizon are in agreement on many important issues. For example, Staff agrees that:

- The provision of DSL TS in the Waiver Areas would be unduly economically burdensome for the Company (Staff Ex. 3.2, Freetly Sup. Reb., p. 1);
- That DSL TS cannot be provided in the Waiver Areas without substantial subsidies (Staff Ex. 2.2, Hanson Sup. Reb., pp. 1-2);
- That shareholders should not have to bear the costs of a mandated deployment of DSL TS (Tr. at 382);

- That inter-service and intra-service subsidies are not efficient and can harm competition (Staff Ex. 4.0, Zolnierrek Reb., pp. 2-3; Tr. at 360, 363); and
- In assessing whether the deployment of DSL TS is in the public interest, the existence of advanced telecommunications services provided by an entity other than an ILEC is a relevant consideration (Tr. at 366).

Notwithstanding these acknowledgements, Staff changed its position in the 11<sup>th</sup> hour to assert that “supranormal” profits from existing DSL TS deployments could subsidize deployments that otherwise could not stand on their own. (Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2; Staff Ex. 4.0, Zolnierrek Reb., pp. 6-7; *see also* Tr. at 247). However, Staff has provided no basis for its position that the supposed “supranormal” profits are in any way relevant to Verizon’s waiver request or that they even exist.

Staff’s intra-service subsidy scenario is erroneous. The record demonstrates that subsidies are inefficient and competitively harmful. (Staff Ex. 4.0, Zolnierrek Reb., pp. 1-2; Verizon Ex. 4.0, Trimble Reb., p. 20). In addition, intra-service subsidies are inconsistent with this Commission’s long-standing policy of eliminating subsidies in rates. (Tr. at 248). Moreover, the record demonstrates that Verizon’s current DSL TS offering in Illinois is experiencing low penetration rates. (Verizon Ex. 7.0, Trimble Sur., p. 22). As such, Staff’s imagined “supranormal” profits simply do not exist. Thus, Staff’s position is unsupported and flawed at its core.

Staff also ignores the General Assembly’s stated policy with respect to investment in advanced telecommunications services. Section 13-103 of the Act provides as follows:

Sec. 13-103. Policy. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that:

...

(f) development of and *prudent investment in advanced telecommunications services* and networks that foster economic development of the State should be encouraged through the implementation and enforcement of policies that *promote effective and sustained competition* in all telecommunications service markets.

220 ILCS 5/13-103 (emphasis added). Clearly, a subsidized DSL TS deployment does not meet the Act's requirement that investment in advanced telecommunications services be prudent and competitively neutral.

The Illinois Attorney General ("AG") presented testimony related only to Verizon's waiver request. The AG incorrectly alleges that Verizon's own data indicates that it can profitably deploy DSL TS to 69.9% of its customers that are within 18 kilofeet ("kf") of a central office. (CUB Ex. 1.0, Dunkel Reb., p. 2). The AG conveniently fails to mention the fact that Verizon expressly stated that the 17% penetration rate was only provided to illustrate that even *under the best of circumstances*, revenues from DSL TS deployment in the Waiver Areas would not be profitable. (See Verizon Ex. 2.0, Trimble Dir. p. 16; Verizon Ex. 4.0, Trimble Reb., p. 30; Verizon Ex. 7.0, Trimble Sur., p. 19). The AG's analysis hinges upon this illustrative penetration rate, which is more than double the actual rate that Verizon is experiencing in Illinois. (Verizon Ex. 7.0, Trimble Sur., p. 20). When the actual penetration rates are incorporated into the AG's analysis, the AG's argument collapses.

Moreover, the fact that the AG and Staff are even attempting to dictate to Verizon what services can be profitable is economically improper and poor public policy. The only prudent and legal course for the Commission is to let the marketplace and new technologies drive appropriate investment decisions.



For the Commission to dictate a carrier's future investment is an ominous path, particularly where the investment is related to a competitive service. While both the AG and Staff are very liberal with Verizon's investment dollars, neither party addresses the very real problems of subsidies, impacts on competition, stranded costs, and economic losses that will arise if the Commission adopts their myopic positions. Advanced telecommunications services should only be deployed where they can stand on their own. Accordingly, Verizon's request for waiver should be granted.

## **II. Background**

Verizon is requesting a certification from the Commission that its current intrastate advanced telecommunications services offerings meet the requirements of Section 13-517 of the Act because it currently offers various services capable of transmitting data at greater than 200 kbps. These services are tariffed, on file with the Commission, and at least one service is available to every Verizon customer.

Verizon requests this certification for two reasons. First, unless a waiver is granted, Section 13-517 of the Act requires an ILEC to offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005. 220 ILCS 5/13-517. Without a certification, Verizon would find itself in violation of Section 13-517 in the event the Commission disagrees that Verizon's current intrastate advanced telecommunications service offerings meet these requirements. With the significant amount of planning and investment necessary to meet the requirements of Section 13-517, it is logical and necessary for this issue to be resolved prior to January 1, 2005.

Second, by the terms of the Order approving the merger of GTE and Bell Atlantic, Verizon is required to file a rate case no later than June 30, 2003. (Application for the Approval

of a Corporate Reorganization involving a Merger of GTE Corporation and Bell Atlantic Corporation, Docket No. 98-0866, p. 45). In light of the significant investment that Verizon would need to make if the relief requested in this docket was not granted, it is imperative that Verizon be aware of these obligations before filing the rate case.

If the Commission does not grant Verizon's request for a certification, Verizon alternatively, seeks a waiver pursuant to Section 13-517 of the Act. Verizon does not have an intrastate offering, aside from those subject to the certification request, which qualifies as an advanced telecommunications service under the Act. (*See* Verizon Ex. 2.0, Trimble Dir., p. 5). If the Commission believes that DSL TS can satisfy the legislative mandate, Verizon notes that DSL TS is an interstate service subject to the jurisdiction of the FCC. (*Id.*) Importantly, the General Assembly did not define DSL TS as the measure to accomplish the mandate (in fact, Section 13-517 is technology neutral), and the ICC has no jurisdiction over such a product. (*See also* 220 ILCS 5/13-517).

Notwithstanding this issue of jurisdiction, which Verizon does not waive, the record demonstrates that DSL TS cannot be deployed without undue economic burden in the additional areas beyond where Verizon has already deployed the service. (Verizon Ex. 2.0, Trimble Dir., p. 17). Verizon currently deploys and is in the process of deploying DSL TS in 37 of its 413 exchanges. (*Id.*, p. 14, fn. 2). Verizon is seeking a full waiver with respect to the Waiver Areas—the 376 exchanges where it has not currently deployed DSL TS. (*Id.*)

The record demonstrates that the Waiver Areas are largely rural and the high cost of deploying DSL TS there is not economically justified in light of the low penetration rates that Verizon has experienced in areas where it already is deployed. (*Id.*, p. 10). A forced deployment in the Waiver Areas will result in significant revenue shortfalls and substantial subsidies. (*Id.*,

p. 17). Verizon has established that a ubiquitous deployment of DSL TS to 80% of Verizon's relatively rural customer base would be impractical and unduly economically burdensome, not only to Verizon (Section 13-517(b)) but to Verizon's customer base (Section 13-517(a)).<sup>1</sup> (*Id.*, p. 9).

The record further demonstrates that other competitors are currently providing advanced services in the Waiver Areas. For example, Intervenor the Village of Mt. Zion ("Mt. Zion") opposed Verizon's proposed waiver, but its witness, Paul Ruff, acknowledged that cable modem services are deployed and readily available to the citizens of Mt. Zion. (Mt. Zion Ex. 1.0, Ruff Reb., p. 1; Tr. at 55). The fact that competition for advanced services exists, and will undoubtedly increase, further supports the fact that subsidized DSL TS is not the answer for these areas. While Staff takes the position that subsidized DSL TS is acceptable, it never addresses the competitive impact such subsidies will have on current and future competitors in these areas. Nor does it address the public policy issues of deploying an uneconomic service when an alternative already exists.

Finally, a critical component to Verizon's waiver request is its proffered BFR Process for the Waiver Areas. (Verizon Ex. 2.0, Trimble Dir., p. 23). Under this proposal, "interest-groups," including community groups, in the Waiver Areas can request a specific analysis of the financial requirements for deploying DSL TS facilities in a designated service area where current estimated market conditions do not warrant deployment of such facilities. (*Id.*) This process allows Verizon and the interest group to engage in analyses, which could lead to rational DSL TS deployment in high-cost market areas. (*Id.*) In short, this process will accommodate what

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<sup>1</sup> For example, a comparison of Ameritech and Verizon indicates that while 92% of Ameritech's customer lines are served by switches that serve geographic areas with more than 300 lines per square mile, only 8.4% of Verizon's lines reside in areas with more than 300 lines per square mile. (Verizon Ex. 2.0, Trimble Dir., p. 12).

the market actually desires, not what various groups believe the public wants, and will ensure there is no undue economic burden on Verizon and its customers. (*Id.*, p. 26).

### **III. Argument**

#### **A. Verizon Meets Section 13-517 Of The Act**

##### **1. Verizon Meets The Act's Advanced Telecommunications Services Requirements**

The language in Section 13-517 is clear and unambiguous:

(a) Every Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005.

...

(c) As used in this Section, "advanced telecommunications services" means services capable of supporting, in at least one direction, a speed in excess of 200 kilo-bits per second (kbps) to the network demarcation point at the subscriber's premises.

220 ILCS 5/13-517.

The record clearly demonstrates that Verizon's current intrastate advanced telecommunications services offerings meet the Act's requirements. Verizon currently offers several intrastate products that satisfy the Act's definition of "Advanced Telecommunications Services" and at least one of these services is available to all Verizon customers today. (Verizon Ex. 3.0, White Dir., pp. 2-4). Verizon's DS-1 service provides data speeds of 1.544 million bits per second ("Mbps") in both directions. (*Id.*) DS-1 service can be provisioned to virtually all customers on demand utilizing copper loops with HDSL technology or with fiber when available. (*Id.*) Verizon's Frame Relay ("FR") service is a "fast packet" service that permits the transmission of data at speeds from 56 kbps up to 1.544 megabits per second. (*Id.*) Verizon's

Asynchronous Transport Mode Service (“ATM”) also is a “fast packet” service that permits flexible data speeds up to and beyond 45 Mbps. (*Id.*) Verizon also offers High Capacity Digital (“HCD”) Services that provide dedicated, point-to-point digital transport capabilities between two customer designated locations. (*Id.*) Verizon witness White provided a detailed explanation of each of these services in his Direct Testimony. No party disputed the fact that these services constitute advanced telecommunications services as defined in the Act. (*Id.*)

**2. Staff’s Interpretation Of Section 13-517 Is Contrary To The Rules Of Statutory Construction And The Plain Meaning Of The Act**

Staff disputed whether these services are “offered” or “provided” as these terms are used in Section 13-517. However, in determining the meaning of these terms, established statutory construction principles dictate that the plain meaning of the terms must be used, not newly created definitions advocated by Staff. *Dept. of Prof. Reg. v. Manos*, 202 Ill.2d 563, 782 N.E.2d 237 (2002)(words used in the statutory provision should be given their plain and ordinary meaning); *Advanced Imaging Center v. Cassigy*, 335 Ill.App. 3d 746, 781 N.E.2d 664 (2<sup>nd</sup> Dist. 2002)(in interpreting a statute, a court begins with its language, which must be given its plain and ordinary meaning); *Prairie Rivers Network v. Ill. Pollution Control Bd.*, 335 Ill.App. 3d 391, 781 N.E.2d 372 (4<sup>th</sup> Dist. 2002).

Contrary to established statutory construction principles, Staff is introducing ambiguity into Section 13-517 that, upon a plain reading of this Section, does not exist. This violates the well-established statutory construction principle that a statute must be read in a manner that avoids ambiguity. *Boylan v. Matejka*, 331 Ill.App. 3d 96, 99, 770 N.E. 2d 1266, 1268 (2<sup>nd</sup> Dist. 2002).

The plain meaning of the term “offer” as used in the context of Section 13-517 is to “proffer” or “make available.”<sup>2</sup> *American Heritage Dictionary of the English Language*, Fourth Edition. The plain meaning of the term “provide” as used in the context of this section also is “to make available.”<sup>3</sup> (*Id.*)

Staff’s position ignores the regular definitions of these commonly understood terms. With respect to “offer,” Staff witness Liu asserts that a service is not offered unless it is marketed to a specific segment of the market and that there is a “reasonable expectation that a sufficient number of end-users in the market would purchase this service at these rates.” (Staff Ex. 1.0, Liu Dir., p. 14).

With respect to the term “provide,” Ms. Liu again sidesteps the plain meaning of the term and opines that:

‘Providing’ differs from ‘offering’. ‘Providing’ a service to an end-user is equivalent to provisioning a service to an end-user. When a carrier offers a service to an end-user and when the end-user accepts the service offering, then the carrier provides (or provisions) the service. In other words, while “offering” a service refers to an offering of a sale contract, “providing” a service refers to the execution of the offered sale contract, which only occurs after acceptance of the offered sale contract. Thus, while Verizon offers Plain Old Telephone Service (POTS) to end-users in its

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<sup>2</sup> The entire definition is as follows:

Offer: To present for acceptance or rejection; *proffer*: offered me a drink. To put forward for consideration; propose: offer an opinion. To present in order to meet a need or satisfy a requirement: offered new statistics in order to facilitate the decision-making process. *To make available*; afford: The situation offers us the opportunity to learn more. To present for sale. To provide; furnish: a hotel that offers conference facilities. To propose as payment; bid. To present as an act of worship: offer up prayers. To exhibit readiness or desire (to do something); volunteer: offered to carry the packages. To put up; mount: partisans who offered strong resistance to the invaders.

*American Heritage Dictionary of the English Language*, Fourth Edition (emphasis added).

<sup>3</sup> The entire definition is as follows:

Provide: To furnish; supply: provide food and shelter for a family. *To make available*; afford: a room that provides ample sunlight through French windows. To set down as a stipulation: an agreement that provides deadlines for completion of the work. Archaic. To make ready ahead of time; prepare.

*American Heritage Dictionary of the English Language*, Fourth Edition (emphasis added).

serving territory, it is only considered as providing POTS service to an end-user when the POTS line connecting the end-user to the public switched telephone network (PSTN) has dial tone, which will occur some time after the end-user accepts Verizon's POTS service offering. Similarly, if Verizon is offering advanced services to 100% of its business customers, this does not mean that Verizon is providing advanced services to 100% of its business customers or that 100% of its business customers have signed on to Verizon's advanced services offerings.

(Staff Ex. 1.0, Liu Dir., pp. 15-16).

Staff's position on this point is wrong on a multitude of levels. First, if the Commission were to adopt Staff's definitions of "offer" and "provide," even Verizon's DSL TS would not meet the requirements of Section 13-517. This is because *Verizon does not offer its DSL TS directly to end-use customers*. (Verizon Ex. 4.0, Trimble Reb., p. 5). Rather, DSL TS is "offered" to ISPs. (*Id.*; Verizon Ex. 7.0, Trimble Sur., p. 23). As such, Staff's argument that a service must be marketed and priced for a particular market segment fails at the outset. Indeed, on cross-examination, it was clear that Ms. Liu's testimony did not consider the fact that Verizon does not offer DSL TS to end-user customers. (*See* Tr. at 349-350). On this point alone, Staff's position should be rejected.

Second, the Act does not specifically define the terms "offer" and "provide." As such, because these terms appear throughout the Act, the General Assembly afforded these terms their commonly understood meaning. *Scadron v. City of Des Plaines*, 153 Ill.2d 164, 606 N.E. 2d 1154 (1992)(undefined statutory terms should be given their plain and ordinary meaning). Staff's new definitions for "offer" and "provide" are contrary to the rules of statutory construction and would turn the entire Act on its head.

For example, the Act defines a telecommunications service as follows:

Sec. 13-203. *Telecommunications service.* “Telecommunications service” means the *provision* or *offering* for rent, sale or lease, or in exchange for other value received, of the transmittal of information, by means of electromagnetic, including light, transmission with or without benefit of any closed transmission medium, including all instrumentalities, facilities, apparatus, and services (including the collection, storage, forwarding, switching, and delivery of such information) used to provide such transmission and includes access and interconnection arrangements and services.

220 ILCS 5/13-203 (emphasis added). Applying Staff’s new definition of these terms to Section 13-203, only services whose rates created a “reasonable expectation that a sufficient number of end-users in the market would purchase this service” would constitute a telecommunications service. This result is obviously inconsistent with the General Assembly’s intent and the Commission’s application of this Section.

Similarly, absurd results occur if Staff’s definitions are applied to the Act’s certification requirements. Section 13-401 provides in part:

No telecommunications carrier *offering or providing*, or seeking to offer or provide, any interexchange telecommunications service shall do so until it has applied for and received a Certificate of Interexchange Service Authority pursuant to the provisions of Section 13-403. No telecommunications carrier offering or providing, or seeking to *offer or provide*, any local exchange telecommunications service shall do so until it has applied for and received a Certificate of Exchange Service Authority pursuant to the provisions of Section 13-405.

220 ILCS 5/13-401 (emphasis added). Again, under Staff’s logic, offering or providing would only occur depending on how the service was priced or marketed. Clearly, adoption of Staff’s position would lead to irrational results.



In other sections of the Act where these terms are used, the General Assembly intended for their plain meaning to be used. For Sections 13-203, 13-401 and 13-517, a tariffed service that is generally available to the public qualifies as being “offered or provided.” Price and demand are not, and cannot be, a part of these definitions. To inject such concepts into these definitions leads to absurd results. Established statutory construction principles dictate that a statute should not be read in a manner that leads to absurd results. In re *Mary Ann P*, 202 Ill.2d 393, 781 N.E.2d 237 (2002)(statutes should be construed in a manner that avoids absurd results); *Shively v. Belleville Township High School Dist. No. 201*, 329 Ill.App. 3d 1156, 769 N.E.2d 1062 (5<sup>th</sup> Dist. 2002).

Rather than apply the clear language of the Act, Staff disregards the General Assembly’s intent through the creation of new definitions to change the meaning of commonly used terms. Staff’s attempt at statutory interpretation should be rejected. Verizon meets the requirements of Section 13-517 and Verizon respectfully requests that the Commission certify this fact.

**3. Verizon’s Current Intrastate Advanced Services Offerings Are The Only Services That The Commission Has Authority To Mandate**

DSL TS is an interstate service that is regulated by the FCC. (Verizon Ex. 2.0, Trimble Dir., p. 5). The rates for DSL TS are contained in Verizon’s FCC Tariffs. (See Tariff F.C.C. No. 20, Section 5 - Part III). As an interstate service, the Commission is without jurisdiction to order a deployment of DSL TS or to regulate its price. Furthermore, if the Commission mandates Verizon to provide a subsidized DSL TS, the Commission is essentially exercising jurisdiction over the price of this interstate service.

Even further, DSL TS is not provided directly to the public. (Verizon Ex. 4.0, Trimble Reb., p. 5). Such service is offered to ISPs. (*Id.*; Verizon Ex. 7.0, Trimble Sur., p. 23). ISPs are not subject to Commission jurisdiction and, thus, cannot be mandated to provide service to

Illinois customers. As such, the fact that Verizon must offer or provide DSL TS to the 80% of its end-user customers is not even possible. On this basis alone, Staff's reliance on DSL TS to meet the requirements of Section 13-517 is incorrect.

Unlike DSL TS, Verizon's FR, ATM, and DS1 services all are offered on Verizon's intrastate tariffs and are available to the public. (Verizon Ex. 2.0, Trimble Dir., p. 5). As such, these services are the only alternatives that are subject to the Commission's jurisdiction under the Act.

**B. Verizon, Alternatively, Seeks A Full Waiver For The Proposed Waiver Areas Pursuant To Section 13-517(b) Of The Act**

**1. Introduction**

Verizon has provided clear and convincing evidence demonstrating that even under the most optimistic of conditions, deployment of DSL TS in the Waiver Areas will result in significant revenue shortfalls. One of the primary drivers is the lack of demand for these services. A recent survey performed by the Office of Economic and Regional Development, Southern Illinois University ("SIU") ("Rural Illinois High Speed Connectivity Technology Development Study – Final Report", June 2002) concluded that only 2% of the respondents that did not currently have high-speed access said they would be willing to pay \$50 per month to obtain such access. (Verizon Ex. 7.0, Trimble Sur., p. 22). This low demand is confirmed by Verizon's actual penetration rates in Illinois. For areas in Illinois where DSL TS has been deployed for three or more years, the penetration rate is ■■■. (*Id.*) This is approximately ■■■ less than the illustrative 17% penetration rate that Verizon utilized in its direct case to show that deployment of this service will not be profitable.

This lack of demand is further confirmed by the fact that even though notice of this proceeding was sent to every Verizon customer in Illinois, only two "customers" intervened.

And, one of these intervenors, Mt. Zion, acknowledged that its citizens already have advanced services readily available to them in the form of cable modem service. (Tr. at 55). The fact that only one other individual came forward is a clear confirmation of the fact that there is no strong demand for these services.

Without sufficient demand, DSL TS deployment cannot be a prudent investment. If the investment is not prudent, by law, it cannot be mandated.<sup>4</sup> 220 ILCS 5/13-103. The record demonstrates that forced deployment of this service will require significant subsidies. As set forth below, such subsidies are not in the public interest, constitute poor public policy, and, are not legal.

In seeking this waiver, Verizon remains committed to working with customers in the Waiver Areas. In conjunction with its alternative waiver request, Verizon also proposes a BFR Process for the Waiver Areas. This process facilitates communication with rural communities and their chosen ISPs and sets forth a process for Verizon to perform a more in-depth evaluation of the financial characteristics of deploying DSL TS in a particular geographic area. (Verizon Ex. 2.0, Trimble Dir., p. 23).

This BFR Process is designed to enable “interest-groups” to request a specific analysis of the financial requirements for deploying DSL TS facilities in a designated service area. (*Id.* pp. 23-24). This process is targeted at interest groups, including community groups, in areas where current estimated market conditions do not warrant (from a financial standpoint) deployment of DSL facilities. (*Id.*) The BFR Process allows the Company and the representatives of the interest group to engage in analyses, which could lead to rational DSL TS deployment in high-cost market areas upon approval by the FCC. (*Id.*)

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<sup>4</sup> Verizon does not waive the argument that DSL TS is subject to the jurisdiction of the FCC.

The BFR Process will demonstrate what the market actually desires, not what various groups believe the public wants. Moreover, the BFR Process balances the interests of all parties, ensuring that there is no undue economic burden on Verizon or its customers. (Verizon Ex. 1.0, Slagle Dir., p. 4). As such, the BFR Process will provide Verizon's customers with a non-biased method to evaluate and implement the further deployment of DSL TS in a rational manner. This process is infinitely more efficient and reasonable than mandating a subsidized DSL TS.

**2. The General Assembly Expressly Intended That Investment In Advanced Telecommunications Services Be "Prudent"**

When the General Assembly codified its intent to encourage the provision of advanced telecommunications services to a high percentage of end users in the state, it did so recognizing that the investment must be "prudent." 220 ILCS 5/13-103. The General Assembly's policy with respect to investment in advanced telecommunications services could not be more clear than it is in Section 13-103 of the Act, which provides in pertinent part:

Sec. 13-103. Policy. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that:

...

(f) development of and *prudent investment in advanced telecommunications services* and networks that foster economic development of the State should be encouraged through the implementation and enforcement of *policies that promote effective and sustained competition* in all telecommunications service markets.

220 ILCS 5/13-103 (emphasis added).

In the instant case, the record overwhelmingly demonstrates that investment in the Waiver Areas is not prudent. Even Staff acknowledges that Verizon cannot deploy DSL TS in these areas without suffering an "undue economic burden." (Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2).

When read together, Sections 13-103 and 13-517 reflect the General Assembly's recognition that the provision of advanced telecommunications services is not prudent in all areas. Accordingly, Section 13-517 contains a waiver provision that provides as follows:

The Commission shall grant such petition to the extent that, and for such duration as, the Commission determines that such waiver:

- (1) is necessary:
  - (A) to avoid a significant adverse economic impact on users of telecommunications services generally;
  - (B) to avoid imposing a requirement that is unduly economically burdensome;
  - (C) to avoid imposing a requirement that is technically infeasible; or
  - (D) to avoid imposing a requirement that is otherwise impractical to implement in exchanges with low population density; and
- (2) is consistent with the public interest, convenience, and necessity.

220 ILCS 5/13-517.

As discussed in detail in the following sections of this Initial Brief, Verizon meets the requirements for a full waiver with respect to the Waiver Areas. Verizon's waiver request is consistent with Section 13-517(b), which explicitly authorizes the Commission to grant a "full or partial waiver" of the requirements of Section 13-517. 220 ILCS 5/13-517(b). Section 13-517 further provides that "...the Commission shall grant such petition *to the extent that, and for such duration as*, the Commission determines that such waiver is necessary...." 220 ILCS 5/13-517 (emphasis added).

While Staff witnesses take issue with Verizon's request for a full waiver, this is simply an issue of semantics. (See Verizon Ex. 7.0, Trimble Sur., pp. 4-5). Verizon's request also could be

characterized as a partial waiver because Verizon has deployed DSL TS in many areas within its Illinois service territory. (*Id.*) As such, whether Verizon is asking for a full waiver for the Waiver Areas, or whether Verizon is requesting a partial waiver of its entire service territory, the results are the same. (*Id.*) In either instance, Verizon's request meets the requirements of Section 13-517(b).

**3. Verizon Satisfied The Requirements For A Waiver Pursuant To Section 13-517(b) Of The Act**

**a. It Would Be Unduly Economically Burdensome To Require The Deployment Of DSL TS In The Waiver Areas**

**(i) Overview Of Verizon's Service Territory**

As described by Verizon witness Trimble, Verizon's Illinois service territory has 413 local exchanges serving approximately 860,000 access lines across approximately 20,000 square miles of operating territory. (Verizon Ex. 2.0, Trimble Dir., pp. 10-11). The vast majority of these exchanges serve rural areas, characterized by low customer density attributes. (*Id.*) The average number of switched lines per square mile is approximately 40 lines within Verizon's territory. (*Id.*) Verizon's Illinois switches, on average, handle fewer than 2,000 lines per switch, with approximately 62% of Verizon's switches handling less than 1,000 switched access lines each. (*Id.*)

A comparison of Ameritech and Verizon indicates that while 92% of Ameritech's customer lines are served by switches that serve geographic areas with more than 300 lines per square mile, only 8.4% of Verizon's lines reside in areas with more than 300 lines per square mile. (*Id.*, p. 12). The following table summarizes these differences:

### General Comparative Statistics

	Ameritech	Verizon
Switched Lines Served	6.8 Million	0.8 Million
Switches	275	417
Average Lines per Switch	24,700	1,930
Square Miles Served	10,700	20,300
Average Lines per Sq. Mi.	635	40

(Verizon Ex. 2.0, Trimble Dir., p. 12).

The record demonstrates that the number of lines in a serving area, as well as the density of that serving area, play a major role in the resulting average cost to serve that area. (*Id.*) As such, the size of the switching entity and density of the area served are major factors in determining the cost to upgrade an area for DSL capabilities. (*Id.*) The record demonstrates that the costs Verizon will incur to deploy DSL TS in its rural areas will be significantly higher, on an average cost per qualified line basis, than the costs a more urban company, like Ameritech, would incur. (*Id.*) Assuming similar rates for advanced telecommunication service between rural and urban customers, Verizon's capability to recover any potential investment costs in rural areas is extremely diminished. (*Id.*)

#### (ii) The Record Demonstrates That The Costs Of Deploying DSL TS In The Waiver Areas Far Exceeds The Reasonably Expected Revenues

Verizon witnesses Slagle and White provided detailed support for Verizon's facility-related cost estimates for deployment of DSL capabilities in an additional 376 exchanges in Illinois<sup>5</sup>, which is what is required in order to allow Verizon to offer a DSL TS that could reach

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<sup>5</sup> Verizon witness Trimble testified that, "...by mid-year 2003, Verizon should have deployed DSL transport capabilities within 37 of its 413 exchanges, leaving 376 exchanges without DSL capabilities." (Verizon Ex. 2.0, Trimble Dir., p. 14, fn 2)

80% of the company's customer base. (Verizon Ex. 1.0, Slagle Dir., pp. 2-3; Verizon Ex. 3.0, White Dir., p. 7). Table 5 from Verizon witness Trimble's Direct Testimony summarizes the total DSL TS deployment costs associated with the Waiver Areas:

**Verizon's DSL Deployment Costs**

Category of Cost	Amount
Advanced Data Network ("ADN")	██████████
AND Interoffice Transport Facilities & Supporting Central Office Infrastructure	██████████
Outside Plant	██████████
TOTAL	██████████

(Verizon Ex. 2.0, Trimble Dir., p. 14).

The record demonstrates that these costs are conservative estimates because they do not incorporate loop conditioning costs. (*Id.*, p. 15). Further, the cost estimates do not include any additional costs that an ISP might incur to facilitate the provision of an end-to-end broadband service (the costs are only for Verizon's regulated network requirements). (*Id.*)

The record further demonstrates that to support the capital expenditure of \$██████████ million, Verizon would need to generate an incremental \$██████████ million in revenues each year. (Verizon Ex. 2.0, Trimble Dir., p. 14). This revenue amount would not provide Verizon with any contributions to cover the Company's common costs; it would cover reasonable amounts for "return of" (*i.e.*, depreciation) and "return on" (*i.e.*, rate of return) the capital invested plus coverage of various operating expenses (*e.g.*, tax; maintenance and repair; billing and collection; and sales expenses). (*Id.*) In determining the necessary revenues to recover costs, the record,



again, demonstrates that Verizon utilized a very low annual charge factor (“ACF”) to develop a conservative (*i.e.*, low) estimation of required revenues.<sup>6</sup> (*Id.*)

Verizon witness Trimble testified that the revenue levels that would be generated would be far short of the \$[REDACTED] million that would be necessary before even minimal costs are recovered. As such, mandatory investments would not be prudent. (Verizon Ex. 2.0, Trimble Dir., p. 14). Mr. Trimble testified:

My optimistic estimate of annual revenues would be about \$[REDACTED] million by year-end 2007; a gap of \$[REDACTED] million annually (noting that the gap would be significantly more in the earlier years until demand grows to the year-end 2007 level). This simple but appropriate analysis reflects why Verizon is requesting a waiver in this proceeding if its existing offerings are deemed insufficient – there is no reasonable expectation that a sufficient level of revenue generation could be achieved to support the deployment of DSL to 80% of Verizon’s customers.

(Verizon Ex. 2.0, Trimble Dir., p. 16).

These figures assume an overly optimistic level of demand. Mr. Trimble’s 2007 revenue estimate assumed an aggressive penetration rate of 17% of all qualified lines that terminate at residential households or business establishments as opposed to the actual market take rate of [REDACTED]. (*Id.*) Even with this overly optimistic take rate, over a five-year period Verizon would under recover costs by more than \$200 million. (*Id.*, p. 17). Table 6 in witness Trimble’s Direct Testimony summarizes end-user demand and the resulting revenue-to-cost shortfall over a 5-year period based on a 17% take-rate:

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<sup>6</sup> Verizon utilized an ACF approach to determining the revenue amount. Verizon witness Trimble testified that ACFs are factors that may be used to convert investment amounts into an annual revenue stream that is required to service the invested capital. These factors have been used in the telecommunications industry for a number of years. For this instant analysis, Mr. Trimble utilized a conservative ACF of 0.20. Multiplying the ACF by the total capital investment gives a reasonable estimate of the annual revenues required to make the investment a minimally, prudent investment. (Verizon Ex. 2.0, Trimble Dir., pp. 15-16).

### Potential Revenue-to-Cost Shortfalls

	2003	2004	2005	2006	2007
A. Beginning Year Units In Service	██████	██████	██████	██████	██████
B. Year-End Penetration	██████	██████	██████	██████	██████
C. Year-End Units	██████	██████	██████	██████	██████
D. Average Revenue Producing Units; [(A+C)/2]	██████	██████	██████	██████	██████
E. Revenues (at \$40 per month) ; [D * 40 * 12]	██████	██████	██████	██████	██████
F. Annual Cost	██████	██████	██████	██████	██████
G. Shortfall ; [F – E]	██████	██████	██████	██████	██████
H. Cumulative Shortfall	██████	██████	██████	██████	██████
Assumptions: All plant is immediately deployed and available 1/2003 and Annual Cost based on a 0.20 ACF					

(Verizon Ex. 2.0, Trimble Dir., p. 18).

The record demonstrates clearly that a 17% penetration rate would be an unrealistic number to achieve in 2007 for a number of reasons. First, in areas where DSL TS is currently deployed, Verizon is not even close to achieving a 17% penetration rate. (Verizon Ex. 7.0, Trimble Sur., p. 22). The actual rate is ██████. Throughout his direct, rebuttal and surrebuttal testimonies, Verizon witness Trimble repeatedly stated that the demand penetration estimates that he employed in the financial analysis were “extremely aggressive.” (Verizon Ex. 2.0, Trimble Dir. p. 19; Verizon Ex. 4.0, Trimble Reb., p. 30; Verizon Ex. 7.0, Trimble Sur., p. 23). As Verizon witness Trimble explained, Verizon provided aggressive penetration rates in order to “...avoid any contentious debate regarding the appropriate level of demand penetration.” (Verizon Ex. 7.0, Trimble Sur., p. 23). Verizon provided data that demonstrates that mandated deployment of DSL TS capabilities to comply with Section 13-517 would be unduly economically burdensome, even with aggressive demand penetration assumptions.

Indeed, the actual [REDACTED] take rate is supported by the results of consumer surveys of rural Illinois customers performed by SIU. (Verizon Ex. 2.0, Trimble Dir., p. 19). The SIU study documented that about only 50% of residential customers have a computer at home. (*Id.*) The study also concluded that 72% of the business establishments have a computer, but given that businesses (on average) have more than one telephone line, only 50% of Verizon's lines terminate to households or business establishments with a computer. (*Id.*) Significantly, the survey concluded that only 2% of non-broadband customers would be willing to pay \$50 per month to obtain such access. (Verizon Ex. 7.0, Trimble Sur., p. 22). The 2% found in the SIU study makes up a majority of the end-users in Verizon's rural serving areas (*e.g.*, consumers without high-speed access). (*Id.*) No party disputed the findings of this study, which were incorporated in Mr. Trimble's Direct Testimony.

Moreover, Verizon's current experience with its deployment of DSL TS is proof that a 17% take rate will not be realized.<sup>7</sup> The record demonstrates that the actual penetration rates in Illinois and throughout other Verizon affiliate ILECs operating territories are significantly lower than 17%. (*Id.*) The following table provides an example of penetration rates for Verizon and its affiliates DSL TS deployments that have been in service three or more years:

State	Penetration Rate
Illinois	[REDACTED]
California	[REDACTED]
New York	[REDACTED]
Ohio	[REDACTED]

(Verizon Ex. 7.0, Trimble Sur., p. 22).

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<sup>7</sup> In fact, the illustrative 17% penetration rate actually reflects 34% of customers that currently have computers.

Clearly, the above actual penetration rates are significantly less than the illustrative penetration rate that Verizon used in its financial analysis when the deployed facilities have been in-service for more than three years. Notably, Mr. Trimble testified that of the states listed above, Verizon's non-DSL TS capable areas in Illinois, which are rural, would most likely resemble Verizon's Ohio service territory, which has a ■■■ demand penetration rate. (*Id.*, p. 23).

In sum, even under Verizon's overly optimistic scenarios for the Waiver Areas, the record demonstrates that the costs of deploying DSL TS far exceed reasonably expected revenues by more than \$200 million. (Verizon Ex. 2.0, Trimble Dir., p. 16).

**4. The Substantial Revenue Shortfalls Associated With A Forced Deployment Of DSL TS In The Waiver Areas Constitutes An Undue Economic Burden**

A primary issue in this proceeding is whether forced deployment of DSL TS in the Waiver Areas would constitute an undue economic burden under Section 13-517 of the Act. 220 ILCS 5/13-517. Verizon and Staff are in agreement on this issue. In her Supplemental Rebuttal Testimony, Staff witness Freetly agreed that deployment of DSL TS in the Waiver Areas would result in an "undue economic burden" to Verizon. Ms. Freetly's states that:

Under the scenario in the Supplemental Rebuttal Testimony of Staff witness Mark Hanson, the impact of offering advanced telecommunications services ("ATS") on Verizon's implied ROE *would appear to constitute an undue economic burden.* Verizon's implied ROE does not return to its last authorized ROE over the forecast period when the pension asset is included in rate base or when that pension asset is excluded from rate base in accordance with the Commission's Order in Docket No. 94-0041. Although the implied ROEs never fall below the 6.79% yield on A-rated utility bonds, under this scenario, the deployment of ATS does not provide Verizon with a fair opportunity to earn a reasonable rate of return over the long-term. ...

(Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2 (emphasis added)).

Staff's conclusion provides a concrete basis for granting Verizon's alternative waiver request. However, Staff takes the position that this undue economic burden could be mitigated if "supra-normal" profits (which, as discussed above, do not exist) from current DSL TS deployment areas subsidize areas where deployment of DSL TS is not profitable. (*Id.*) This new position, which first appears in Staff witness Zolnierrek's Rebuttal Testimony and then is further reflected in Ms. Freetly's Supplemental Rebuttal Testimony, exposes a major inconsistency in Staff's position on the definition of an "undue economic burden." (Staff Ex. 4.0, Zolnierrek Reb., p. 7; Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2). On this issue, Staff is all over the map.

On the one hand, Staff correctly views an undue economic burden as one where the incremental costs are greater than the incremental revenues. As Staff witness Liu testifies:

- Q. Should the Commission establish a generic or general standard to apply to all carriers in assessing whether compliance with the requirements of Section 13-517 would be "unduly economically burdensome"?
- A. Although I recommend that the Commission establish the general framework within which it will determine whether compliance is "unduly economically burdensome" – that is, in the context of whether *the incremental cost associated with compliance are greater than the incremental revenue* – I do not think it is either advisable or possible to establish a specific test or standard to be applied in all cases....

(Staff Ex. 1.0, Liu Dir., p. 6 (emphasis added); Tr. at 276).

This approach is reasonable. It is consistent with the economic principles of efficiencies that Staff witness Zolnierrek discusses in detail in his testimony. (Staff Ex. 4.0, Zolnierrek Reb., pp. 2-3). It requires that the deployment of DSL TS in the Waiver Areas to stand on their own—rather than rely on substantial intra-service subsidies. This approach also is consistent with the General Assembly's stated policy that investment in advanced telecommunications services must

be prudent, and that investment should be encouraged through “policies that promote effective and sustained competition in all telecommunications service markets.” 220 ILCS 5/13-103.

On the other hand, Ms. Liu also testifies that the determination of undue economic burden depends, in part, on the size of the company and its resources:

.... I recommend that the Commission assess whether compliance would be “unduly economically burdensome” on a case-by-case basis, since the particular facts and circumstances can and will vary significantly between carriers. To illustrate, consider the following hypothetical case. Suppose the costs of meeting the 80% requirement for a carrier exceeded the incremental revenues by \$10 million. If this company were in excellent financial health, and had, for example, \$200 million in cash or other retained earnings, the Commission likely could determine that it would not be economically burdensome to meet the requirement. In contrast, if the company were in poor financial health, the \$10 million could in fact be economically burdensome. *Other important factors in this regard could include such things as the size of the company, the number of customers, and so forth.* Such important factors vary between carriers, and in many cases very significantly. The Commission should preserve its ability to fully judge each case on its merits, and to consider the many factors that may influence whether compliance with the requirements of Section 13-517 would be “unduly economically burdensome”.

(Staff Ex. 1.0, Liu Dir., pp. 6-7 (emphasis added)).

Staff witness Liu’s definition of “unduly economically burdensome” is groundless. Inherent in her reasoning is that a carrier’s shareholders bear the burden of a government mandated investment. This is patently unreasonable on its face—especially in light of the fact that it is the government that is mandating the investment in an unprofitable venture. There simply is no basis for this position in the Act. There also is no Commission precedent for this position. Even Staff witness Zolnierrek testified on cross-examination that Staff’s recommendation “does not call for or require” that Verizon shareholders bear the burden of DSL TS deployment. (Tr. at 382).

The fundamental flaw in this analysis is the fact that Staff witness Liu makes the determination of undue economic burden in stark isolation. Her view of what constitutes an undue economic burden improperly turns a blind-eye to whether the investment itself is prudent. Indeed, on cross examination, Staff witness Liu could not agree that it would be unduly economically burdensome for the company to hypothetically make a \$100 million DSL TS investment and have only one customer takes this service. (Tr. at 328). This position is outrageous, unreasonable and inconsistent with the General Assembly's clear mandate regarding the "...development of and *prudent investment in* advanced telecommunications services...." 220 ILCS 5/13-517 (emphasis added). Taken to its logical extreme, Staff witness Liu's definition of undue economic burden would lead to a requirement to make the investment even if the projected penetration rate is zero. This interpretation clearly is in conflict with the Act.

In contrast to Staff witness Liu, Staff witness Zolnierrek has a different view of what constitutes an undue economic burden. On cross-examination, Staff witness Zolnierrek testified that the existence of alternative advanced services is "something that should be considered" in determining whether DSL TS deployment causes an undue economic burden. (Tr. at 370). This is logical because competitive alternatives can affect the penetration rate. However, no Staff witness discussed this point in their direct or rebuttal testimonies. Clearly, on one of the primary issues in this proceeding, there is a significant inconsistency between Staff witnesses as to what constitutes an undue economic burden.

The correct approach is the incremental approach, as Ms. Liu first stated in her direct testimony. In such an analysis, the Commission must weigh the incremental costs and benefits associated with the investment, and the amount of investment should be compared with the overall benefits that the investment will produce. In the instant case, the high investment cost coupled with inadequate revenues clearly should be a factor in deciding whether the economic

burden is an *undue* one. In light of the fact that the General Assembly made it an express policy that investment must be prudent, this cost/benefit analysis is legally required. 220 ILCS 5/13-103.

The substantial revenue shortfalls associated with a forced deployment of DSL TS in the Waiver Areas constitutes an undue economic burden. The Commission should therefore grant Verizon's waiver request.

**a. The Deployment Of DSL TS In The Waiver Areas Would Cause A Significant Adverse Economic Impact On Users Of Telecommunications Generally**

**(i) Staff Is Advocating A Heavily Subsidized DSL TS**

Verizon has presented data that demonstrates that DSL TS cannot be economically deployed in the Waiver Areas. (Verizon Ex. 2.0, Trimble Dir., p. 16). Indeed, as discussed above, Staff expressly acknowledges that such deployment would cause an undue economic burden because the incremental costs of deployment in these areas exceed incremental expected revenues. (Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2).

The Commission's rules provide a clear and unambiguous definition as to whether a service is subsidized.

**Section 791.90 Subsidy Tests**

- a) A service is not being subsidized if the total revenue resulting from the service equals or exceeds the long-run service incremental cost of providing that service.

83 Ill. Admin. Code §781.90.

Staff does not dispute that the mandated deployment of DSL TS in the Waiver Areas would require substantial subsidies. (Staff Ex. 2.2, Hanson Sup. Reb., pp. 1-2). And, Staff also includes a substantial discussion of the evils associated with subsidies generally in the testimony



of Dr. Zolnierrek. (Staff Ex. 4.0, Zolnierrek Reb., pp. 2-5). However, it is Staff's position that the Commission does not have a choice because of the language in Section 13-517 of the Act. (*Id.*)

Indeed, subsidized DSL TS is at the center of Staff's competing waiver proposal. Staff's case hinges on its position that "supranormal profits" from current deployment of DSL TS should subsidize deployment in areas where costs exceed expected revenues. This position first is set forth in Staff witness Zolnierrek's testimony:

*Verizon may be required to deploy advanced services in particular areas when deployment to those areas requires the company to subsidize otherwise unprofitable deployment in the area with supranormal profits earned from the provision of advanced services in other areas. Thus no cross service subsidy would be required. In addition Verizon may be required to deploy advanced services in particular areas when deployment in those areas does not impose an undue economic burden on Verizon from a financial standpoint. However, if Verizon were required to raise rates for POTS or other non-advanced service to support deployment of advanced services, then I would agree that deployment would impose a significant adverse economic impact on users of telecommunications services in general.*

(Staff Ex. 4.0, Zolnierrek Reb., pp. 7-9 (emphasis added); *see also* Tr. at 247).

This position is reiterated in Staff witness Freetly's position:

*It is not appropriate to exclude the effects of the current deployment because then the analysis does not reflect the profitability of the service in full. Therefore, the financial impact on the company may be overstated in this analysis, depending on the profitability of ATS that Verizon already offers and provides.*

(Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2 (emphasis added)).

As discussed below, Staff's reasoning is faulty at every level.

**(a) Mandated Deployment Of Subsidized DSL TS Is Economically Inefficient and Anti-Competitive**

In determining the effect of subsidies, one need look no further than the testimony of Staff witness Zolnierrek, which describes how subsidies are inefficient and anti-competitive.

Staff witness Zolnierrek testified that:

- Q. Mr. Trimble asserts that “mandated deployment of a subsidized service ... would raise various competitive neutrality issues ...” Do you agree that the mandated deployment of a subsidized service generally raises competitive neutrality issues?
- A. Yes. In broad terms, a service is subsidized if the price for the service is set below the costs to provide that service. As a general rule, prices set below costs are economically inefficient. When the price charged for a service is set below the cost of producing that service then consumers will (on the margin) consume the service even when the value they place on the service is less than the societal value of the inputs needed to produce that service. In general such an outcome is not economically efficient.
- Subsidization of service can also deter efficient providers from entering markets. If for example, Verizon charges less for advanced services than it costs the company to produce these services, then carriers that can provide comparable advanced services at the same or even at a slightly lower cost than Verizon may not enter the advanced services market.

(Staff Ex. 4.0, Zolnierrek Reb., pp. 2-3; *see also* Tr. at 379). Dr. Zolnierrek is correct on this point. Subsidies are not economically efficient and they do send inefficient price signals. They also deter efficient competitors from entering markets. Moreover, it is the long-standing policy of this Commission that cost-causers should be the cost-payers and subsidies should be eliminated from rates.

The problem is that while Staff acknowledges that subsidies are inefficient, it turns a blind eye to these problems. While Staff understands and acknowledges the problems with

subsidies, it is willing to tolerate them based on a misguided and incorrect interpretation of the Act. Absent this incorrect interpretation, Staff's testimony regarding subsidies strongly supports Verizon's position.

Following is an excerpt from Dr. Zolnierrek's testimony that sets forth the crux of Staff's case:

- Q. Does a requirement that advanced services deployment in certain areas be funded by provision of advanced services in other areas create a significant adverse impact on users of telecommunications services in general?
- A. Section 13-517(a) requires ILECs to offer or provide advanced services to 80% of their customers. Although I am not a lawyer, *I understand Section 13-517(a) to impose some obligation on the ILECs in excess of what they would have done as a company concerned only with the direct profitability associated with offering and providing advanced services.*

Carriers may not offer or provide advanced services based purely on the direct profitability of offering or providing service for strategic reasons or because of indirect profitability considerations. For example, an ILEC might elect not to deploy otherwise profitable DSL service because customers may switch from its other products (e.g., T1s/DS1s) and reduce the ILECs overall profitability. In my opinion, mandating deployment in such circumstances does not in general cause any adverse impact on users of telecommunications services.

*Certainly, requiring intraservice cross-subsidies creates some of the economic efficiency and competitive effects I identified above. Therefore, such intraservice cross subsidies do have at least to some extent an adverse impact on users of telecommunications services. However, such intraservice cross subsidies do not in every instance constitute a significant adverse economic impact.*

(Staff Ex. 4.0, Zolnierrek Reb., pp. 7-8 (emphasis added)). In essence, Dr. Zolnierrek advocates subsidies for two reasons: 1) Staff interprets Section 13-517 as mandating subsidized advanced telecommunications services; and 2) Staff believes that intra-service subsidies are more tolerable

than inter-service subsidies. Staff's conclusions are simply incorrect and unsupported. Taken one statement at a time, it is clear that Staff's position lacks any merit whatsoever, and is illegal.

**(b) Staff's Recommendation Of Mandated Deployment Of Subsidized DSL Transport Service Is Inconsistent With The Explicit Policy Objectives Of The Act**

Staff is wrong in its position that the Commission has no choice but to tolerate intra-service subsidies because of the language of Section 13-517. Dr. Zolnierrek's understanding of the Act is flawed for the following reasons.

First, Dr. Zolnierrek's legal interpretation of Section 13-517 omits the related Section 13-301 requirement that investment in advanced telecommunications services must be prudent. 220 ILCS 5/13-103. Not only does Section 13-103 require prudent investment, the General Assembly went further and defined the context in which such investment should be encouraged. In no uncertain terms, the General Assembly stated the importance of "effective and sustained competition." 220 ILCS 5/13-103. It is difficult to fathom how a subsidized DSL TS could constitute a "prudent investment." Furthermore, Staff never reconciles its position with the anti-competitive effect that subsidized DSL TS will have on new competitors—something that the General Assembly clearly seeks to avoid.

When read together, Sections 13-103 and 13-517 require that a waiver be granted for areas where investment in advanced telecommunications services is not prudent. This is the only reasonable interpretation of these Sections. To state otherwise would have the effect of negating the specific policy guidelines included in Section 13-103.

In effect, Staff seeks to make advanced telecommunications services a supported universal service. Aside from this view being inconsistent with Section 13-103, Staff's

interpretation is deeply flawed because the General Assembly could have made advanced telecommunications services a supported service, but did not do so. *See* 220 ILCS 5/13-301.

In sum, Staff's case rests entirely upon its faulty interpretation of the Act. Indeed, it seems that Staff never even considered the policy guidelines set forth in Section 13-103. Absent Staff's incorrect interpretation, Staff's testimony regarding subsidies supports Verizon's position that the waiver should be granted.

**(c) DSL TS Is A Federally Regulated Service And, As Such, The Commission Has No Authority To Mandate Subsidized DSL TS**

Staff did not dispute that DSL TS is an interstate service. As such, Verizon's DSL TS offerings are entirely regulated by the FCC. (*See* Tariff F.C.C. No. 20, Section 5 - Part III). These tariffs contain the prices that ISPs are charged for purchasing Verizon's DSL TS.

As an interstate service, the Commission is without jurisdiction to order a deployment of DSL TS or to regulate its price. Moreover, the price for DSL TS contained in Verizon's interstate tariffs is based on voluntary and profitable deployment. By mandating an unprofitable deployment of DSL TS, the Commission clearly would be applying inappropriate pressure on the interstate price and the interstate price would need to increase in order to maintain the same interstate margin. Accordingly, Staff's position that DSL TS should be subsidized usurps the FCC's authority on the pricing of interstate services and, as such, should be rejected.

**(d) Staff's Statement That Intra-Service Subsidies Are More Tolerable Than Inter-Service Subsidies Is Totally Unsupported And Incorrect**

Staff's entire position in this case hinges on its acceptance of intra-service subsidies. Again, Staff speculates that Verizon's "supra-normal profits" from its current deployment of DSL TS should subsidize areas where deployment would not be profitable on its own. (Staff

Ex. 4.0, Zolnierrek Reb., pp. 6-7; Tr. at 247). Even though Staff's entire case rests on the concept of intra-service subsidies, Staff simply provides one sentence in its testimony that intra-service subsidies are tolerable: "...(h)owever, such intraservice cross subsidies do not in every instance constitute a significant adverse economic impact." (Staff Ex. 4.0, Zolnierrek Reb., pp. 7-8). Staff provides no reasoning for this statement.

Staff witness Zolnierrek never explains himself on this issue. He does not differentiate between the inefficiencies of intra-service versus inter-service subsidies. He says nothing—except that one is more tolerable than the other. Indeed, there is nothing Dr. Zolnierrek could say to justify this unreasonable position. He uses his faulty interpretation of the Act to justify his carving of an exception to established economic principles—principles that this Commission has strongly subscribed to for many years.

The record demonstrates that Dr. Zolnierrek is flatly wrong. Intra-service subsidies are as anti-competitive as inter-service subsidies and they also suffer from the same inefficiencies.

Dr. Zolnierrek acknowledges that subsidies are anti-competitive because they have a chilling effect on competition. (Staff Ex. 4.0, Zolnierrek Reb., pp. 2-3; Tr. at 360, 363). One need only ask a competitor that seeks to enter a market that is already served by subsidized DSL TS whether it makes any difference where the subsidy comes from or whether it matters whether the subsidy is inter-service or intra-service. *Is the subsidy less anti-competitive if it comes from another DSL TS customer, rather than a POTs customer?* Obviously not. (See Verizon Ex. 4.0, Trimble Reb., p. 20).

Moreover, Dr. Zolnierrek states that subsidies result in improper price signals to users of the service. Again, one need only ask whether the source of the subsidy has any effect on the price signal. Again, it does not. (*Id.*)

Staff avoids any discussion of this issue. However, its cursory conclusions cannot serve as support for a total change in Commission policy regarding subsidies.

Verizon witness Trimble testified:

The definition of subsidization under the Commission's rules does not concern itself with how a product got to market; its focus is whether the product is priced below its incremental cost. Such prices are usually considered to be improper or anti-competitive. Whether the ILEC is required to absorb the excess costs or whether end-users are required to contribute to cost coverage through increased rates for other services, the service remains a subsidized service—the service's price is below the service's incremental cost.

(Verizon Ex. 7.0, Trimble Sur., p. 20).

Staff did not present any analysis to support its totally unreasonable position that the Commission should mandate subsidized DSL TS. Its unsupported conclusions should be rejected.

**(e) Staff's Assertion That Supranormal Profits Exist In Areas Where Verizon Has Currently Deployed DSL TS Has No Basis In The Record**

Dr. Zolnierек proposes that Verizon should be required to support any unprofitable deployment with the "supranormal profits earned from the provision of advanced telecommunications services in other areas." (Staff Ex. 4.0, Zolnierек Reb., pp. 6-7; Tr. at 247). Indeed, on cross-examination, Staff witness Hanson admitted that he was "assuming" that Verizon's current deployments were profitable because they met Verizon's investment threshold. (Tr. at 280). This "supranormal" profit argument fails at its inception because the assertion that such profits exist is unsupported.

Moreover, Dr. Zolnierек never specifies what he means by supranormal profits. However, Verizon witness Trimble properly define the term as follows:

I would define them as profits that result from being able to exercise significant market power – which would imply that the Company has the ability to profitably charge rates above competitive market levels for a significant period of time. The key phrase here is “above competitive market levels.” Supranormal profits are not based on analyzing the service’s price in comparison to the incremental costs of the service; it is based on the service’s price as compared to competitive market rate levels. There’s no evidence that Verizon is generating or has the ability to generate supranormal profits from its provision of DSL transport services.

(Verizon Ex. 7.0, Trimble Sur., p. 6).

The record demonstrates that Verizon does not have any market power in the provision of DSL TS.<sup>8</sup> (*Id.* at 7). In addition, prices for DSL TS are regulated by the FCC which assures that unilateral action cannot be taken by the Company. (*Id.*) Additionally, with the availability of competitive alternatives to DSL TS, there is no likelihood for Verizon to experience supranormal profits. Dr. Zolnierak acknowledged that these alternatives already exist in the areas where Verizon seeks a waiver. (Tr. at 368). Indeed, Mt. Zion acknowledges that cable modem service is available to the residents and businesses of that village.<sup>9</sup> (Tr. 55). As Verizon witness Trimble testified, “...competitive markets have the uncanny capability to target and ultimately erase any “supranormal” profits” even if they existed. (*Id.*)

**(f) Staff’s Position Ignores The Commission’s Long-Standing And Well Established Policy That Cost-Causers Should Be The Cost-Payers**

The Commission has a long-standing policy that cost-causers should be cost-payers. In almost every industry, one can find a body of Commission caselaw espousing the need for rates to be free of subsidies. For example, for each of the major industries regulated by the

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<sup>8</sup> This fact is consistent with the Commission’s “Annual Report on Telecommunications Markets in Illinois” (“Annual Report”). The Annual Report states that cable modem providers served “nearly twice as many subscribers as ADSL wireline telephone providers at year-end 2001.” (Annual Report, p. 3, dated October 23, 2002).

<sup>9</sup> This statement also is consistent with the Commission’s Annual Report, which states that cable modem service is a “close substitute” for ADSL. (Annual Report, p. 26).



Commission, telecommunications, electric and gas, the Commission has removed most subsidies between business and residential customers. There are literally countless cases where the Commission has expressed its disdain with subsidies, whether inter-service or intra-service.

One need only look at the Commission's numerous decisions relating to intrastate universal service funding to understand that the Commission is opposed to subsidies of plain old telephone service ("POTS"). (*See e.g.*, Order, Docket Nos. 97-0601, 97-0602, 97-516 consol.). Additionally, the Commission has rejected the request of carriers seeking USF support under Section 13-301(d) of the Act for USF funding of non-primary lines. (*See e.g.*, 2<sup>nd</sup> Interim Order on Rehearing at 22, 23).

The Commission has historically maintained "that high speed data transmission or Internet access should not be services included in the definition of universal service." Further, the Commission also recognized that subsidizing advanced telecommunications services would have harmful competitive-neutrality effects. As such, the Commission recommended to the FCC that it "... should continue to rely on the marketplace to promote the deployment of advanced services." (*See* Counsel for Commission letter to FCC regarding comments on review of the definition of Universal Service, Nov. 5, 2001; Verizon Ex. 4.0, Trimble Reb., p. 20). It is exactly this position—reliance on the marketplace—that is the cornerstone of Verizon's request for a waiver of Section 13-517.

Staff's position disregards this long-standing and correct policy of eliminating subsidies in rates. The path that Staff recommends is a slippery slope and it will chill competition and create subsidies that, once instituted, will become difficult to eliminate. Staff has not provided even a cursory discussion of these problems in its testimony. As such, Staff's position is not grounded on prudent policy and should be rejected.

**b. Subsidized DSL TS Is Inconsistent With The Public Interest, Convenience, And Necessity**

The forced deployment of an unprofitable service is not in the public interest. As explained above, subsidies, whether inter-service or intra-service, are inefficient and anti-competitive.

It cannot be disputed that subsidizing DSL TS will have a detrimental effect on competition for advanced telecommunications services. (Verizon Ex. 4.0, Trimble Reb., p. 20; Staff Ex. 4.0, Zolnierек Reb., pp. 2-3; Tr. at 360, 363). Again, even Staff admits this fact. (Staff Ex. 4.0, Zolnierек Reb., pp. 2-3; Tr. at 360-363). This detrimental effect manifests itself in two ways. First, current competitors providing advanced telecommunications services in the Waiver Areas should not have to compete against a subsidized DSL TS. (Staff Ex. 4.0, Zolnierек Reb., p. 3).

The second detrimental effect on competition is the effect on future innovations and more efficient solutions to providing advanced telecommunications services. Communication technology is evolving quickly. (Verizon Ex. 3.0, White Dir., pp. 5-6). Wireless, both cellular and satellite is also seeing significant improvements in speed and availability. (*Id.*) Staff repeatedly acknowledges that the near future will likely involve significantly upgraded technologies. (Staff Ex. 1.0, Liu Dir., pp. 9-10; Tr. at 375). While this point is acknowledged, Staff, nonetheless, continues to assert that investment in DSL TS should be subsidized. These inconsistent views cannot be reconciled.

While Dr. Zolnierек's testimony contains a discussion of the evils associated with subsidies of services, he never addresses the effect that subsidies can have on competition for advanced services. With respect to the issue of public interest, Dr. Zolnierек states that subsidies are not always detrimental to societal welfare. According to Dr. Zolnierек:

There are instances where policy makers may rationally subsidize services in order to meet equity objectives that may enhance welfare. For example, policy makers may determine that subsidizing education enhances societal welfare, thereby permitting some consumers to obtain an education at a price below the cost. Additionally, policy makers may determine that welfare is enhanced by funding basic research and development, which may permit research firms to supply innovations or information to consumers at rates below the cost of producing such innovations or information. Although I am not a lawyer, my understanding of Section 13-517(a) is that the General Assembly has determined that deployment of advanced services by ILECs will serve the public interest.

(Staff Ex. 4.0, Zolnierrek Reb., p. 3).

The examples of proper subsidies provided by Dr. Zolnierrek have no relevance in the instant docket. Each of the examples presented above involves funding through *taxpayer* dollars or potentially through some form of competitively neutral charges, neither of which Dr. Zolnierrek proposes in this proceeding. (Verizon Ex. 7.0, Trimble Sur., pp. 7-8). Moreover, Dr. Zolnierrek could not provide a single example of a mandated subsidy from a non-governmental entity. Certainly there are no Commission orders containing an analogous situation.

Dr. Zolnierrek's statements regarding the toleration of intra-service subsidies lack substance. He presents hypothetical situations that are not applicable and offers no real analysis or support for his conclusions. Accordingly, Staff's position that subsidies are acceptable should be rejected.

**c. Deployment Of DSL TS In The Waiver Areas, Where There Is Low Population Density, Is Impractical**

No party disputes that the vast majority of Verizon's exchanges serve rural areas characterized by low customer density attributes. Additionally, no party disputes that the number of lines in a serving area as well as the density of that serving area play a major role in

the resulting average cost to serve that area. There is no dispute that this is the reason that Section 13-517 includes a waiver provision in the first place.

As such, the costs that Verizon will incur to deploy DSL TS in its rural areas will be significantly higher than the costs to a more urban company, like Ameritech. (Verizon Ex. 2.0, Trimble Dir., p. 12). If Verizon is to charge similar rates for advanced telecommunication service between rural and urban customers, Verizon's capability to recover any potential investment costs in rural areas is extremely diminished. (*Id.*, p. 13). If Verizon charges higher rates for rural customers, it is likely that Verizon's actual penetration rates, let alone its already optimistic penetration rates, will plummet in these areas—further exacerbating the revenue shortfall.

As discussed earlier in this brief, Verizon will not recover its costs to meet the requirements of Section 13-517. Accordingly, consistent with the waiver provisions of the Act, the Commission should find that it is impractical to require deployment of DSL TS facilities and grant the requested waiver. (*See* § III.B above).

## **5. Verizon Properly Provided Data Pertaining To The Waiver Areas**

Staff acknowledges the reasonableness of Verizon's direct case requesting a waiver when Ms. Liu stated that an undue economic burden occurs where the incremental costs of deployment are greater than the incremental revenues. This is essentially what Verizon provided the Commission. Staff witness Liu testified as follows:

- Q. Please describe an appropriate approach or standard to determine when it is 'unduly economically burdensome' for a carrier to deploy advanced services to 80% of the customers?
- A. This standard should be based on the concepts of incremental cost and incremental revenue. Incremental costs refer to the 'extra' costs incurred if the carrier

(Verizon in this proceeding) is to offer advanced services beyond its current deployment to meet the 80% requirement of the PUA. The incremental revenue refers to the 'extra' revenue that would potentially be generated from the 'extra' advanced services customers. The 80% requirement of Section 13-517 of the PUA should be deemed as 'unduly economically burdensome' if and only if the incremental cost is 'significantly' greater than the incremental revenue of meeting the requirement.

(Staff Ex. 1.0, Liu Dir., pp. 5-6).

While Staff witness Liu testified that an incremental analysis is appropriate, in Staff witness Freetly's Supplemental Rebuttal Testimony, Staff has taken the new position that it now needs data relating to Verizon's *full deployment* of DSL TS throughout the state before it can take a position. (Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2). This position is inappropriate.

There are four major flaws in Staff's new position. First, the data that Staff seeks is not relevant to this Docket. Verizon is not seeking a waiver for the areas where DSL TS is currently deployed or already slated for deployment. Staff provides no basis whatsoever in its supplemental testimony as to why this additional data is necessary. Staff only provides a conclusion. Without an adequate explanation as to the reason for needing this data, Staff's last minute change in position is baseless and should be ignored.

Second, the only possible relevance for this additional data is for current deployment to subsidize deployment in the Waiver Areas, where DSL TS deployment would not be profitable on a stand-alone basis. Staff witness Zolnierak acknowledged this fact during cross-examination. (Tr. at 378). As stated above, Staff is taking the position that intra-service subsidies of DSL TS are acceptable and, thus, it is likely that Staff is now asking for this information in order to support this position. For reasons set forth in earlier sections of this brief, subsidies are totally improper and inefficient. Furthermore, this information is not relevant

because the Commission does not have the legal authority to mandate subsidies of a service that is exclusively subject to federal jurisdiction.

Third, Staff's own witnesses stated on cross-examination that Staff had not previously asked for this data. (Tr. at 359; Tr. at 275, 281). Nowhere in Staff's testimony is a need for this data stated. Clearly, Staff did not consider this data relevant at the time that its direct or rebuttal testimony was filed.

Finally, Verizon has provided information indicating that its penetration rates for DSL TS are significantly lower than the illustrative 17% rate provided in its waiver request. (Verizon Ex. 7.0, Trimble Sur., p. 22). As such, even without Verizon's data on full deployment, it goes without saying that profits are not "supra-normal." Clearly, Staff's request for such new data is inappropriate and should be rejected.

**6. Staff Statements That They Did Not Have The Information Required To Perform Their Analysis Is Not Credible**

Verizon provided the Commission with detailed information regarding the Waiver Areas. Staff repeatedly implies that it did not have the proper information that it needed. (*See, e.g.* Tr. at 274, 366). Indeed, it is now Staff's position that it cannot make a recommendation unless it receives information regarding Verizon's entire deployment of DSL TS in Illinois. (Staff Ex. 3.2, Freetly Sup. Reb., pp. 1-2). This position is surprising in light of the fact that nowhere in any of the previous testimonies of the Staff witnesses was this "deficiency" even mentioned. In fact, Staff witnesses Zolnierrek and Hanson, each stated on cross-examination that they never asked for this data. (Tr. at 359; Tr. at 275).

Staff's statements regarding lack of data should be given no weight. Staff simply has no basis for making any such assertions. For example, the most important data Verizon provided in this Docket was its incremental financial data. (*See* Verizon Ex. 2.0, Trimble Dir., pp. 13-14).

On cross-examination, Staff witness Hanson testified that it was only after reading Verizon witness Trimble's Surrebuttal Testimony, that he realized that Verizon has provided financial data on an incremental basis. (Tr. at 277). Staff's assertion that it did not understand that data was incremental in nature should be given no credence whatsoever. This statement is plainly wrong and surprising in light of the numerous times that Verizon expressly stated that the data was incremental in nature.

Verizon witnesses Trimble and Slagle made this point abundantly clear in direct testimony. Verizon witness Trimble plainly stated in his Direct Testimony as follows:

- Q. What would it cost Verizon to deploy and maintain a DSL-capable network so that Verizon could offer or provide DSL transport service to at least 80 percent of its customers?
- A. Witnesses Slagle and White provide the detailed support for Verizon's facility-related cost *estimates for deployment of DSL capabilities in an additional 376 exchanges in Illinois*, which would allow Verizon to offer a DSL transport service that could reach 80 percent of the company's customer base. I have summarized the results of their studies in Table 5.
- ...
- Q. What amount of *incremental annual revenues* would Verizon need to achieve to financially support the expenditure of \$[REDACTED] million in capital?
- A. To support the capital expenditure of \$[REDACTED] million, Verizon would need to generate (approximately) an *additional* \$[REDACTED] million in revenues each year. This revenue amount would not likely provide Verizon with any contributions to covering the Company's common costs, but should cover reasonable amounts for "return of" (i.e., depreciation) and "return on" (i.e., rate of return) the capital invested plus coverage of various operating expenses (e.g., tax; maintenance and repair; billing and collection; and sales expenses.).

(Verizon Ex. 2.0, Trimble Dir., pp. 14-15).

Verizon witness Slagle testified as follows:

- Q. How many active DSL Central Offices are there in the State of Illinois?
- A. Verizon currently has 49 active DSL central offices in Illinois. This is made up of 28 central offices, where DSL has been deployed, and an additional 21 planned offices, where DSL is scheduled to be deployed by year-end 2002.
- Q. Have you estimated how much it would cost to deploy this DSL network to all of the *non-active* Central Offices?
- A. Yes. The capital cost of the ADN-related equipment has been calculated at approximately \$33M and would support forecasted demand thru 2007. To calculate the cost of central office conditioning requirements and of the DS3 facilities that would connect each office to its serving hub, would require a time-consuming office-by-office analysis. However, based on a sampling of 20 Illinois offices, we project that these costs may run as high as \$41.4M, bringing the total cost to nearly \$75M. This estimate does not include the additional capital that would be required to deploy an advanced data network to the required remote terminals, as well as outside plant costs that will be discussed by Verizon witness John White.

(Verizon Ex. 1.0, Slagle Dir., pp. 2-3 (emphasis added)).

Moreover, Verizon witness Trimble reiterated the fact that the data was incremental in nature in his Rebuttal Testimony:

- Q. Mr. Trimble, how would you classify the Company's filed cost estimates to ubiquitously deploy DSL transport services?
- A. The costs represent "conservative", short-run *incremental* cost estimates. The estimates presented by Messrs. Slagle and White are short-run, *incremental* costs in the sense that if appropriate capital assets are already in place, no additional capital dollars were ascribed to use of those assets. But, using existing assets also has a cost that should be associated with the use. If costs are not ascribed to the use of existing assets, then those costs are not incorporated into the determination of the service's overall cost (which should drive pricing decisions), and the associated assets



have no opportunity to generate revenues for recovery of their real underlying costs. In essence, nothing is free, and the question is how to facilitate cost recovery. As such, the costs upon which the financials were developed are definitely conservative in terms of representing the actual costs for which Verizon needs to seek recovery.

(Verizon Ex. 4.0, Trimble Reb., p. 24 (emphasis added)). Indeed, Mr. Trimble used the word “incremental” 14 times his rebuttal testimony.

Staff witness Hanson’s statement that it was only after reading Verizon witness Trimble’s Surrebuttal Testimony that he realized that Verizon had provided financial data on an incremental basis is simply not credible. (Tr. at 277). As such, there is simply no reasonable basis for Staff to repeatedly calculate data and provide testimony that applied Verizon’s financial information as if it applied to Verizon’s total deployment of DSL TS. (See Verizon Ex. 7.0, Trimble Sur., p. 10). Nonetheless, even if Staff could provide a legitimate reason for its confusion, there is no reason that a simple data request was not sent to clear up their confusion on this important issue.

**C. The AG’s Position Is Founded Upon A Total Misuse Of Verizon Data**

The AG takes the position that Verizon’s own data indicates that it can profitably deploy DSL TS to its customers that are within 18 kf of a central office. (CUB Ex. 1.0, Dunkel Dir., p. 2). The AG also goes one step farther and states that with some adjustments to Verizon’s financial data, Verizon can profitably deploy DSL TS to 80% its customers. (*Id.*, p. 10). The AG is wrong on both counts. The record demonstrates clearly that it is inappropriate to use Verizon’s analyses in the manner the AG suggests.<sup>10</sup>

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<sup>10</sup> The AG also mistakenly assumes that the Commission has jurisdiction over DSL TS and its pricing. As noted *infra*, the Commission does not have such jurisdiction. Accordingly, Verizon does not waive its jurisdiction arguments when otherwise responding to the AG’s position.

## 1. The AG Misuses Verizon's Data

In making its assertion that Verizon can profitably deploy DSL TS to its customers that are within 18 kf of a central office, the AG misuses the data that Verizon has provided in this proceeding to support its waiver.

The problem is simple. As the record demonstrates, Mr. Trimble's testimony supporting the waiver used an aggressive demand factor to show that this service would not cover costs under this illustrative scenario, much less the actual Verizon Illinois take-rate of [REDACTED]. (Verizon Ex. 2.0, Trimble Dir., p. 19; Verizon Ex. 4.0, Trimble Reb., p. 30; Verizon Ex. 7.0, Trimble Sur., p. 23). If the AG were to use the actual data, such as the penetration rates that Verizon is currently experiencing in Illinois and in other states, the AG's case would collapse.

The record overwhelmingly demonstrates that Verizon's expected penetration rates would be the [REDACTED] take-rate being experienced where DSL TS has been deployed in Illinois. (*See* Section B(3)(a)). Despite this fact, the AG relies not on actual experience for penetration rates, but instead on the illustrative figure in order to arrive at its erroneous conclusion. Such use of the illustrative figure is wholly inappropriate and should be rejected.

Further exacerbating the errors in the AG's analysis is its complete failure to consider other competing technologies, whether existing or emerging. Such technologies, such as cable-modem service, will place even more downward pressure on Verizon's expected penetration rates. Without even a scintilla of consideration of such facts, it is readily apparent that the AG's "profitability" position has no basis in reality and should not be accepted.

In conclusion, Verizon provided aggressive penetration rates in order to "...avoid any contentious debate regarding the appropriate level of demand penetration." (Verizon Ex. 7.0, Trimble Sur., p. 2). Verizon provided data that demonstrates that mandated deployment of DSL

TS to comply with Section 13-517 would be unduly economically burdensome, even with the most optimistic of demand penetration assumptions. However, as the AG attempts to use this data as assumptions for its own analysis, it has ignored the more rational actual demand penetration rates. Indeed, the AG could not do so because its entire case would crumble if actual penetration rates were utilized in its analysis. For these reasons, the AG's analysis is not sound and should be rejected.

**2. The AG's Analysis Is Flawed And Does Not Take Into Account The Time Value Of Money**

Aside from the fact that his analysis is based on unrealistic penetration rates, Mr. Dunkel omits to mention that even under his analysis that central office-only based deployment would only begin to have a positive revenue-to-cost position starting sometime in 2007 (some five years after capital deployment). (Verizon Ex. 7.0, Trimble Sur., p. 23). Mr. Dunkel conveniently omitted to discuss revenue-to-cost streams associated with earlier years. (*Id.*, p. 19). Furthermore, a positive revenue-to-cost flow in any given year does not indicate that the subject investment has turned profitable. (*Id.*) As Verizon witness Trimble testified, "...an appropriate analysis would minimally look at the net present value of the cash flows over the revenue producing life of the capital investment." (*Id.*)

Mr. Trimble's testimony provides the following annual cash flows inherent in Mr. Dunkel's analysis:

Year	Revenue Over Cost (\$000)	Cumulative Revenue Over Cost
2003		
2004		
2005		
2006		
2007		

(Verizon Ex. 7.0, Trimble Sur, p. 20).

It is apparent from the data that by year-end 2007, central office-only deployment is far from achieving recovery of its total annual costs. The AG's statement that such deployment is profitable is simply not credible.

### **3. The AG's Position That Verizon Can Profitably Deploy DSL TS To 80% Of Its Customers Is Based On Assumptions That Are Wrong**

The AG also goes one step farther and states that with some adjustments to Verizon's financial data, Verizon can "profitably deploy DSL Transport Service to 80% of its customers." (AG Ex. 1.0, Dunkel Dir., p. 10). Aside from being based on an inappropriate penetration rate, AG's proposed adjustments are simply baseless.

AG witness Dunkel alleges that Verizon's financial data contains two flaws: (1) including duplicative maintenance and other non-capital expenses, and (2) elimination of revenues appropriately associated with the incremental costs that Verizon submitted. (*Id.*, pp. 10-13). The AG takes the position that if these two corrections are made, Verizon can profitably deploy DSL TS to 80% of its customers. The record demonstrates that it is the AG's analysis that is faulty.

With respect to the AG's first allegation, the record demonstrates that the maintenance expenses associated with the required capital are correctly estimated. Each assumption that underlies the AG witness Dunkel's conclusions is flawed for numerous reasons.

First, AG witness Dunkel asserts that the Company would not have to install any new remotes or cables to provide DSL TS to Central Office-served customers. (AG Ex. 1.0, Dunkel Reb., p. 7). Mr. Dunkel is wrong. Verizon witness Slagle testified that new Interoffice fiber cable to connect the Central Office or Remote Switch location to Verizon's backbone ATM network will have to be installed in some instances. (Verizon Ex. 6.0, Slagle Sur., p. 2). Mr. Dunkel did not address these costs in his analysis.

Second, AG witness Dunkel states that DSLAMS are available that slide into the remote and that DSL TS subscribers would connect back to the Central Office over the existing fiber. (CUB Ex. 1.0, Dunkel Reb., p. 8). This is incorrect. The record demonstrates that not all of Verizon's Remote Terminal locations have the necessary right-of-way, cabinet space, power, or cross-box capacity to support a 'slide-in' DSLAM and, thus, would require extensive upgrade costs. (Verizon Ex. 6.0, Slagle Sur., p. 3). Even among those that could readily support a 'slide-in' DSLAM, a separate fiber pair(s) is often required to transport the DSL traffic back to the central office. DSL traffic is not necessarily carried over the same fiber pairs as voice traffic. (*Id.*) Indeed, on cross-examination it was clear that Mr. Dunkel's testimony was based on speculation rather than actual knowledge of the equipment involved in provisioning DSL TS. (Tr. at 208-212).

Third, AG witness Dunkel asserts that Verizon's analysis includes the cost to provide DSL TS to exchanges that already offer DSL TS. (CUB Ex. 1.0, Dunkel Reb., p. 11). Again, the record demonstrates that Mr. Dunkel is wrong. As Verizon witness Slagle testified, Mr. Dunkel did not consider the fact that because DSL TS is already offered in a community (or exchange) does not mean that it is available everywhere in that exchange area. (Verizon Ex. 6.0, Slagle Sur., p. 3). Many communities (or exchanges) consist of a main Central Office and 1 or more remote switches that serve a certain geographic section of the exchange and that are located

at a physically separate site. (*Id.*) Customers served from a remote switch location cannot be provided DSL TS using the DSLAM equipment located in the main Central Office. (*Id.*)

Verizon witness Slagle noted that in developing costs, Verizon included only the incremental cost to deploy DSL TS at those Central Offices and remote switch locations that were not already DSL equipped. (*Id.*) Verizon did not include the cost for Central Offices that were already activated nor those planned to be activated in 2002. (*Id.*)

Verizon witness Slagle provided the following example of this:

Mr. Dunkel cites Bloomington as an example of an exchange that is already activated with DSL and that he believes was included in our cost study. He is incorrect. Our cost calculations included only the incremental cost to deploy DSL to the remote switch location that is hosted from the Bloomington Main central office and that was not already equipped with DSL capabilities. This was necessary to ensure that customers served from this site would be included in the 69.9% figure we were providing in our testimony. Therefore, the cost to deploy services to customers served by this remote switch in Bloomington (and to other previously unequipped Remote Switch locations in 'active' DSL exchanges) is appropriate to be included in our calculations and should not be removed.

(Verizon Ex. 6.0, Slagle Sur., pp. 4-5).

Finally, AG witness Dunkel's assertion that maintenance costs for old cables should be removed from the Company's cost assumptions is also faulty and indicative of a basic misunderstanding of the equipment involved in provisioning DSL TS. (AG Ex. 1.0, Dunkel Reb., p. 12). The record demonstrates that to deploy DSL TS at remotes that use copper cables between the remote and the central office, Verizon would have to incur the cost to place new fiber optic cables to feed the remote DSLAM. (Verizon Ex. 6.0, Slagle Sur., p. 4). This new fiber optic cable would not be a 'replacement' for the cable that feeds the narrowband customers.

(*Id.*) Those cables would remain to provide voice services and Verizon would continue to incur the maintenance costs associated with these cables. (*Id.*)

AG witness Dunkel also is incorrect in his second alleged flaw that Verizon improperly eliminated revenues appropriately associated with the incremental costs that Verizon submitted. Verizon witness Trimble explained that Mr. Dunkel's analysis suffers from the same inconsistency as Mr. Hanson's original (since revised) analysis—they both incorporate an estimate of projected "total" Company DSL TS revenues and compares that revenue estimate to the "incremental" cost to facilitate post year-end 2002 deployments. (Verizon Ex. 7.0, Trimble Sur., p. 18). As stated earlier in this brief, Verizon witnesses Trimble and Slagle explicitly explained that all of Verizon's filed cost estimates are incremental cost estimates. (Verizon Ex. 2.0, Trimble Dir., pp. 14-15; Verizon Ex. 1.0, Slagle Dir., pp. 2-3). Accordingly, associated revenues used in any comparison with the "incremental" costs must only incorporate revenues associated with the "incremental" capital deployment. (*See* Verizon Ex. 2.0, Trimble Dir., p. 20).

In conclusion, none of Mr. Dunkel's recommended adjustments to Verizon's financial data are appropriate. It is evident from these mistakes that Mr. Dunkel misunderstands Verizon's filed material and, furthermore, lacks a fundamental knowledge of how DSL TS is provisioned. His mistakes have resulted in him asserting conclusions that cannot be supported by rational analysis. Absent these erroneous adjustments, Mr. Dunkel cannot support his allegation that serving the required 80% is profitable. The record demonstrates that Table 7 of Verizon witness Trimble's Direct Testimony remains unscathed and stands as it was originally developed. (Verizon Ex. 2.0, Trimble Dir., pp. 2-3). As such, the record demonstrates that deployment to comply with the 80% requirement of Section 13-517 would be unduly economically burdensome and financially irresponsible. (Verizon Ex. 7.0, Trimble Sur. p. 19).

The AG's calculated "adjustments" were totally discredited in Verizon's surrebuttal testimony. As such, these adjustments lack merit and do not support the AG's position that DSL TS can be profitably deployed.

**D. The Positions Of Staff And AG Are Based On An Incomplete Analysis**

First, implicit in the AG's position is the premise that DSL TS must be profitably deployed. To this extent, the AG's position is clearly more reasonable than the position of Staff, whose position is grounded upon substantial subsidies. Aside from the fact that "profitability" is not the legal test, the problem is that the AG misuses Verizon's data and provides an analysis that does not take into account all of the factors involved in making a determination as to whether a service is profitable.

Again, the premise that the AG and Staff can better determine what services are profitable to deploy simply is ludicrous on its face. Undoubtedly, Verizon is in the best position to determine whether a particular service is profitable or not. If deployment of a particular service is expected to be profitable, it goes without saying that Verizon would seek to deploy the service on its own accord.

The analyses of Staff and AG illustrate the problems associated with having an outside party make what should be an internal business decision. Both the AG and Staff are pushing for deployment of a service without taking into account all of the data that is essential to making this decision. This is not surprising because while both the AG and Staff are free and liberal with Verizon's funds, they provide no analysis or comment whatsoever regarding the consequences if, as Verizon warns, deployment of DSL TS results in substantial revenue shortfalls. Indeed, the AG and Staff are silent as to the following questions:

- What happens to Verizon's substantial investment in DSL TS if take rates are as low as other areas where Verizon has currently deployed?



- How will the proliferation of cable modem service and other advanced services alternatives affect the penetration rates that the AG and Staff hinge their positions on?
- How will Verizon's investment be affected if other potential competitors complain that Verizon is providing DSL TS below cost?
- What will happen to Verizon's substantial investment if new lower cost and more efficient alternatives become available in the near future?
- Who will pay for the substantial stranded costs if the deployment of DSL TS is not profitable?<sup>11</sup>

As the record demonstrates, each of the above questions represents a real concern for Verizon and it should be a concern for the AG and Staff, but they simply look the other way and never address these issues. (*See* Tr. on Reopening at 84-85). This is indicative of the incomplete nature of their respective analyses. For this reason alone, the analyses of Staff and the AG are deeply flawed and should be rejected.

**E. Forcing Verizon To Deploy DSL TS At A Substantial Loss Is Unreasonable And Ignores The Fact That Other Advanced Telecommunications Services Options Are Currently Available, And That Other Lower Cost Alternatives Are Likely To Emerge In The Near Future**

The record demonstrates that other advanced services options, comparable to DSL TS, are available in some of the Waiver Areas. (Tr. at 55). The record further demonstrates that other options may soon be available. These include wireless DSL, satellite internet and fixed wireless. (Tr. at 99-100).

Staff witness Liu acknowledged that such changes will occur. In this regard Ms. Liu testified that:

Technology and other demographic factors change over time. What is true today may not be true five years from now. The factors or evidence that may induce the Commission to grant

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<sup>11</sup> Verizon notes that on cross-examination, Staff witness Freetly stated that she did not consider the possibility of stranded costs in her analysis. (Tr. 235)

Verizon a Section 13-517 waiver today may no longer exist several years from now.

(Staff Ex. 1.0, Liu Dir., pp. 9-10).

This passage in Ms. Liu's testimony actually exposes a major inconsistency in Staff's position. On the one hand, Staff opposes the granting of permanent waiver because of the numerous changes that are likely to occur with respect to technology and demographics. At the same time, Staff supports the permanent deployment of an unprofitable DSL TS.

In reality, the forthcoming changes that Staff acknowledges have the effect of elevating the already high risk associated with the proposed deployment of DSL TS in the Waiver Areas. The record demonstrates that DSL TS deployment will not be a profitable endeavor for Verizon in these areas. Changes in technology will only exacerbate this problem and could leave Verizon and its ratepayers with a huge amount of stranded costs. As such, it simply is not logical or legal for the Commission to mandate a substantial investment in DSL TS when the record demonstrates that it cannot be profitable.

**F. Advanced Services Are Already Available In Mt. Zion**

It is not in the public interest to require the uneconomic deployment of DSL TS to areas that have access to other alternatives. Mt. Zion presented testimony opposing Verizon's waiver request. (Ruff Dir., Mt. Zion Ex. 1.0). On cross-examination, Mr. Ruff testified that the citizens of Mt. Zion already have access to cable-modem service. (Tr. at 55).

In its report to the General Assembly, the Commission has stated that cable-modem service is a comparable substitute to ADSL service. (Annual Report, p. 26). Deployment of an uneconomic service to areas that already have comparable services available does nothing to further the policies or goals of the Act. In fact, such a requirement would be contrary to the

Act's goal of having prudent investment in advanced telecommunications services, while ensuring competitive neutrality. 220 ILCS 5/13-103.

**IV.**  
**Conclusion**

For the foregoing reasons, Verizon respectfully requests that the Commission certify that Verizon's existing advanced telecommunications services offerings meet the requirements of Section 13-517 of the Act. In the alternative, Verizon respectfully requests that the Commission approve Verizon's request for a waiver of the advanced telecommunications services requirements of the Act, in accordance with Section 13-517.

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Respectfully submitted,

VERIZON NORTH INC. AND  
VERIZON SOUTH INC.

By: \_\_\_\_\_  
One of their attorneys

John E. Rooney  
Sonnenschein Nath & Rosenthal  
233 South Wacker Drive  
Chicago, Illinois 60606  
(312) 876-8000  
jrooney@sonnenschein.com  
mguerra@sonnenschein.com

A. Randall Vogelzang  
Verizon Services Group  
600 Hidden Ridge  
Irving, Texas 75038  
randy.vogelzang@verizon.com

**CERTIFICATE OF SERVICE**

I, John E. Rooney, hereby certify that I served a copy of the Initial Brief of Verizon North Inc. and Verizon South Inc. in Docket No. 02-0560 upon the service list by email on March 17, 2003.

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John E. Rooney